Ricardo Semler and Semco S.A.

Introduction

In 1982 at the age of 24, Ricardo Semler took control of Semler & Company, a business founded and, until then, managed by his father. At that time, this Brazilian company's organizational structure, like many historical Latin American enterprises, was a paternalistic, pyramidal hierarchy led by an autocratic leader with a rule for every contingency. Upon taking office, the younger Semler began dramatic organizational restructuring. Among other things, he immediately renamed the company Semco, eliminated all secretarial positions, and implemented an aggressive product diversification strategy. Most observers predicted that these actions would destroy the company.

Semler's changes, however, did not bring about the demise of the struggling industrial equipment manufacturer. Rather, they created a remarkably flexible organization whose sales grew from $35 million in 1990 to $100 million in 1996. Semco became one of the most sought-after employers in Brazil, manufacturing over two thousand different products, including marine pumps, commercial dishwashers, digital scanners, filters, and mixing equipment, and diversified into banking and environmental services. Over 150 Fortune 500 companies visited Semco in an attempt to discover the secret of its success. Ricardo Semler's accomplishments were all the more remarkable when considered against the backdrop of the erratic economy that all of Brazil operated under as the country weathered four currency devaluations, record unemployment, hyperinflation, and a virtual cessation of all industrial production.

Background

Attracted by Brazil's rapidly expanding economy, Austrian-born engineer Antonio Curt Semler moved to Sao Paulo in 1953 after years of managing a plant for DuPont in Argentina. There he founded Semler & Company and began manufacturing centrifuges. Within a decade, the company became a market leader, primarily due to the acquisition of lucrative contracts that provided marine pumps to the military. Antonio Semler quickly focused the resources of the company on providing these pumps to the government. Semler & Company eventually grew into one of the major suppliers of the National Shipbuilding Plan supported by several Brazilian governments.

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After graduating from Harvard at the age 20, one of the school's youngest-ever MBA graduates, Ricardo Semler returned to Sao Paulo to work for his father. From his arrival, it was clear that Ricardo's organizational philosophy clashed with that held by his father. The elder Semler firmly believed in autocratic, paternalistic control, as well as the inextricable connection between personal and business matters. Ricardo advocated a more participatory management style, as well as a strict separation of work and personal life. During the years that followed, these differences in philosophy were a constant source of conflict. Both father and son began to realize that any eventual transfer of power would not represent a continuation of the status quo.

The Brazilian recession of the early 1980s hit Semler & Company particularly hard. At that time, the company derived 90% of its sales from shipbuilding products. The younger Semler was convinced that the future success of the company hinged upon diversification into other product lines, but no one, least of all his father, was willing to listen. Because of Ricardo Semler's dissatisfaction with both the management of the firm and its strategic direction, he threatened to leave during his third year. Faced with this possibility, Antonio Semler retired as CEO and transferred majority ownership to his son. Ricardo Semler was finally in a position to implement his own managerial and strategic philosophy.

The Semco Era

The key to management is to get rid of the managers.
The key to getting work done on time is to stop wearing a watch.
The best way to invest corporate profits is to give them to the employees.
The purpose of work is not to make money. The purpose of work is to make the workers, whether working stiffs or top executives, feel good about life.

Ricardo Semler

On his first day as the new CEO, Ricardo Semler fired two-thirds of the top management of Semler & Company, many close friends of his father, and began plotting a product diversification strategy for the newly renamed Semco.

Semler worked long hours to save the faltering business and made some limited progress in his first year toward the eradication of the old Semler & Company organizational legacy. However, it was not until he fainted while touring a factory in the United States and was diagnosed with a severe case of stress that he decided to drastically change his lifestyle and that of his employees. Semler had not yet postulated a strategic vision, but clearly perceived "a sense of lifelessness, a lack of enthusiasm, a malaise at Semco, and [knew] that [he] had to change it..."

During the years that followed, Semler dismantled the rigid management structure imposed by his father in favor of a more flexible organization based on three interdependent core values: employee participation, profit sharing, and the free flow of information.

The Beginning of the Revolution….

Semler firmly believed that *all* people desire to achieve excellence. He felt that autocracy thwarted people's motivation and creativity. He thus decided that the authority to make decisions at Semco should be more evenly distributed.

His first attempts took the form of a matrix structure similar to that of Delaware-based W.L. Gore, a company Semler had long admired. Under this system, Semco managers reported not only to their plant manager but also to a director at headquarters. This, Semler felt, would provide managers with multiple perspectives on each problem. Initial reactions to the matrix were less than favorable. If pleasing one boss was difficult, pleasing two simultaneously was impossible. In order to avoid conflict, Semco managers became overly cautious, took few risks, and learned little.

The shortcomings of the matrix structure prompted Semler to divide the company into autonomous business units, each headed by a general manager. He believed that this would eliminate what he considered to be the main obstacles of effective participatory management: size, hierarchy, and insufficient flow of information. The business unit approach, however, revived the fiefdoms and inter-unit competition that had inhibited growth in the days of Ricardo's father.

Finally in the mid-1980s, Semco manager João Vendramin convinced Semler to create a *lattice organization*. Under this program, self-managed groups of six to ten manufacturing employees were placed in charge of all aspects of production. To promote a sense of true ownership of the process, the groups were charged with setting their own budgets and production goals. Tying salaries to monthly budget and production performance aligned employee and organizational goals. With the implementation of the *lattice*, unit production costs fell dramatically while employee productivity soared.

Employee adoption of Semler's *lattice* organization was by no means easy. Between October 1985 and January 1987, one-third of Semco's middle managers quit. They were not accustomed to self-managed teams and perceived a sudden loss of power. Factory workers were reluctant to accept the increased responsibility and accountability. Both workers and managers were forced to dispense with deeply rooted cultural values concerning corporate governance.

Profit Sharing

Semler also resorted to more traditional means of employee motivation, instituting a profit-sharing plan in which employees receive roughly one-quarter of the net profits of their respective divisions. Given Semco's rapid growth, these distributions could easily double or triple a worker's salary. A distinguishing feature of Semco profit-sharing was the use of a democratically selected committee to develop and implement the program, as well as disbursement of the profit-sharing funds. Although the funds were generally divided equally among all workers, there were times when the committee took it upon itself to distribute the bonus via housing loans to qualified workers.

The democratic nature of the process drastically reduces employee complaints regarding the allocation of funds. It also exemplifies Semler's trust in his employees' abilities to make decisions, as well as his firm belief in the democratic process.

The 1990s

In response to hyperinflation during the early 1990s, Brazilian President Collor's administration placed restrictions on access to liquidity. As a result, a severe recession ensued during which many companies in Brazil were forced to file bankruptcy. Semco survived by drastically cutting costs. New uniform orders were canceled. Coffee breaks were limited and workers organized into autonomous teams that sold output directly to clients. Throughout 1990, upper management at Semco met with groups of employees to devise cost-cutting strategies. The only feasible solutions seemed to be layoffs or salary cuts. One group of workers, the shop floor committee, expressed a willingness to accept a pay cut subject to three conditions:

1) An increase in profit-sharing to 39% of net income until current salaries could be reinstated;
2) A 40% salary cut for management;
3) The right to approve every expenditure by Semco in order to assure the workers' sacrifice was not in vain.

Prevailing Brazilian labor laws required payment of two years' severance pay for each employee dismissed. Semler saw no choice but to accept the shop floor committee's offer, as the alternative would be to bankrupt the struggling company. Labor's partnership with Semco management during these negotiations marked the beginning of a major cultural shift toward democratic worker management, i.e., worker participation in planning, decision-making and implementation.

Workers' willingness to perform multiple job duties during this difficult period, from driving forklifts to filling in on production lines, produced a highly cross-trained and knowledgeable staff. Armed with this comprehensive knowledge of the workings of the factories, employees began to devise novel, more efficient ways of organizing work. In one factory, workers divided themselves into three manufacturing units, each with approximately 150 members. Each unit had responsibility for the marketing, sales, financial management, and human resource management of its respective product line. The duplication of effort inherent in redundant functions was more than offset by the increase in worker productivity. Ultimately, inventories fell 65%, product delivery times decreased substantially, quality improved, and product defects declined to less than 1% of total production. Semler attributes the increase in productivity to the decrease in team size. He believes that *"people will perform at their potential only when they know almost everyone around them, which is generally when there are no more than 150 people."*

The initial success of autonomous teams formed around product lines prompted their adoption throughout Semco. Workers organized in this manner seemed comfortable with higher levels of responsibility and accountability. Over time, these teams took it upon themselves to hire and fire co-workers *and* bosses by democratic vote. Rigid procedures and autocratic managers gave way to democratic worker management and self-directed work teams. Flexibility guided by common sense became the rule, rather than the exception.

In the meantime, managers began to perceive their new roles within the organization as that of facilitators; providing workers with the tools to make informed decisions. Managers furnished training, information (financial and operational), and all other necessary support for workers to perform their jobs more effectively. To the managers' amazement, employees not only met but surpassed their expectations under the new system.

A Satellite Business

In the late 1980s, three engineers at Semco submitted a proposal to take a small group of employees "raised in Semco's culture and set them free." The stated aim of the group was to invent and reinvent new products, refine marketing strategies, expose production inefficiencies, and dream up new lines of business. They would work without titles, bosses, or subordinates. They would choose their areas of activity, set their own agendas, shift assets as they pleased, and have complete freedom to change their minds. They would even be free to offer their goods and services to the external market. And they would do all this with Semco's equipment and facilities. Twice a year, they were expected to report to senior management, at which time their mandate would be extended for another six months or be revoked. Given the risk of the venture for the firm, they agreed to accept as compensation a percentage of the sales, savings, or royalties resulting from their efforts. Semler, true to his belief in democratic autonomous teams, approved the proposal.

At the end of the first six months, the Nucleus of Technological Innovation (NTI) team had eighteen projects in progress. It quickly became a fast-moving and successful model for change at Semco. In 1990, Semler and his senior managers decided to encourage the creation of more satellites like NTI throughout the organization. Semco management recognized the enormous potential that such satellites possessed in helping release the creative, entrepreneurial spirit of other employees. As an added incentive to foster growth of the satellites, management guaranteed initial contract work for the new satellites and deferred lease payments on all equipment and office space for two years. Satellite businesses turned out to be among the most innovative and agile divisions within Semco. Workers thrived on complete accountability and responsibility, understanding that failure to perform to expectations would result in the likely discontinuation of their unit. Today, roughly two-thirds of Semco's new products come from satellite companies, and two-thirds of its employees work in these organizations.

The New Semco

Semco has no receptionists, secretaries, or personal assistants. All employees, Semler included, receive their own guests, make their own copies, and draft and send their own correspondence. There are no private offices, workers set their own hours, and office attire is at the discretion of each employee. Job titles carry little formal status since all workers are actively encouraged to question and constructively criticize their peers and managers. To illustrate Semler's "hands-off" management style, he states, "*I don't sign a single check, I don't approve investments. I don't run the company in that sense at all. What I do is spend a lot of time being called into meetings about strategy, about pricing, ...I visit customers…*"

Semco's standard policy is not to have one. Semco's policy manual is a twenty-page booklet filled with cartoons and brief declarations outlining the culture of the organization. With respect to *participation*, the manual states the following:

> *Our philosophy is built on participation and involvement. Don't settle down. Give opinions, seek opportunities and advancement, always say what you think. Don't be just one more person in the company.*

Since 1982, Semco's corporate staff has been reduced by 75%. What was once twelve layers of management bureaucracy was reduced to three concentric circles. The small innermost circle consisted of six Counselors who determined general policy and strategy, and attempted to catalyze the actions of those in the second circle. Each of the Counselors, including Semler, took a six-month turn as CEO. The second circle, known as the Partners, included seven to ten leaders of each Semco division. All remaining employees, or Associates as they were known at Semco, comprised the outermost circle. Scattered within this circle were triangles representing permanent and temporary team leaders. Marketing, sales and production managers, engineers and foremen all fell within this classification. Semler eloquently contrasted the new organizational structure as resembling a bottom-heavy bottle of Portuguese rosé rather than the taller (old hierarchical model) bottle of Bordeaux.

Over the thirteen years from 1985 to 1998, employees were gradually expected to assume greater responsibility over everything from cafeteria menus to new product designs to plant relocations. Employees were always free to become cross-functional in any areas of the business they chose and to transfer to different units or participate however they saw fit. A true indication of Semco's adoption of a democratic, participatory management style is that all Associates were encouraged to openly oppose and reject proposals by upper management, and were comfortable doing so. In effect, Ricardo Semler no longer owned Semco; he merely owned the capital.

It was the associates who truly drove Semco. Semler himself summed it up best when he said:

> *[One of the] things that you're not able to presume is to control the destiny of this bunch of people who are trying to control their own destiny. And…you have no control over the destiny of the company... You can't say, I want a $100 million company. You can't. You've got to hope that the system itself and people's interest in self-preservation and self-motivation will take you to a place that's approximately what you'd like to have. I haven't suggested anything in a long time…*

Free Flow of Information

Semco made all of its financial data available to all employees. In fact, Semco developed a course to train employees in the interpretation of balance sheets and statements of cash flow. Profits and losses for each division were common knowledge, and everyone knew the salaries of upper managers (incidentally, their salaries were capped at ten times the average entry level salary). All meetings, including those of the Counselors, were open to all employees who wished to attend. Naturally, all who attended could command equal voting power. This free flow of information served two purposes. It gave associates the information necessary to make informed decisions, and reinforced the democratic nature of the decision-making process.

Strategy

By 1998 Semco maintained only a limited number of functions totally in-house. This included top management, applications, engineering, some research and development, and a few other high tech, capital intensive functions considered to be within Semco's range of core competencies. The firm had moved all other functions to its satellite companies or had completely outsourced to other firms. Many upper-level managers initially opposed outsourcing on the grounds that it would produce information leaks and result in the loss of competitive advantage. Semler, however, firmly believed that competition is inevitable, and competitive advantage comes only from continuous innovation. Moreover, the close relationship between Semco and its satellites meant that most competitive data effectively remained within the organization. Semler felt that Semco held little in the way of strategic information, and that excessive planning inhibited spontaneity and creativity. To support his contention, Semler pointed to the fact that 10-15% of the company's profits came from environmental consulting. How likely was it that environmental consulting would have appeared in Semco's strategic plan ten years earlier?

Because of Semco's ever-changing nature, Semler felt that a corporate mission statement was unnecessary. In his words, *"an articulation of company values or vision is just a photograph of the company as it is, or wants to be, at one given moment...no one can impose corporate consciousness from above. It moves and shifts every day and with every worker. Like planning, vision at its best is dynamic and dispersed."*

Profit and Loss Responsibility

Semco's adherence to the principles of democratic worker management brought both a sense of individual freedom and a necessary commitment to financial accountability. At Semco, the two were inseparable. In return for the autonomy that it grants to each manufacturing cell, Semco demanded accountability. To achieve accountability, there had to be some way for the firm to objectively measure the success or failure of each cell. In the midst of Semco's productive chaos, the bottom line was arguably the only way to fairly measure performance. Semco's profit-sharing plan reinforced this criterion and gave each associate a strong incentive to improve the company's profitability.

Every Semco associate was measured according to his or her contribution to the bottom line. Those who didn't measure up were ultimately pushed out, like it or not. According to Semler:

> *There's not much compassion. There's no place for it really when you've exchanged the bottom line for compassion, because the bottom line is what gave you that freedom. So when you screw with the bottom line, you screw with the freedom, and that's why the compassion goes away.*

Salaries

Associates at Semco set their own salaries. What prevented associates from overpaying themselves? First, all salaries were publicly posted. Those who paid themselves exorbitant salaries must work with resentful colleagues. Second, associates set budgets and decided the fate of their colleagues. If an employee overpaid himself in one six-month period, he might find himself unemployed in the following six. Because Brazilian law prohibited salary reductions, temporarily pricing oneself out of the market was always a risk.

Hiring, Firing, and Evaluations

At Semco, the associates who would actually work with a new recruit decided whom to hire, regardless of whether the new associate would be a co-worker or boss. However, because no one individual had the power to fire another, associates never had to worry about winning the favor of any one individual. Indeed, associates would not hesitate to challenge even Ricardo Semler's opinion.

Every six months when new budgets were drafted, employees bid for positions. Bids were accepted or rejected based on an associate's talents and skills, requested salary, and their colleagues' willingness to re-hire them. In addition, associates evaluated their managers and the company as a whole. Semler expected all "bosses to be relaxed, secure, fair, friendly, participative, innovative, trustworthy, and highly competent." Managers were rated on a one-hundred-point scale and the results publicly posted. Managers who did not consistently score above seventy-five were eventually voted out of the company. Even Ricardo himself was not exempt from evaluation in this manner. To ensure that due process was given to each case, very careful consideration was given to those associates with a minimum of three years' experience and/or over the age of fifty.

Conclusion

Semco's transformation from an autocracy to an entrepreneurial democracy took fifteen eventful years. In the words of Semler, the change proves *"that worker involvement doesn't mean that bosses lose power;"* it merely strips away *"the blind irrational authoritarianism that diminishes productivity."*

Semler felt that the organizational change process at Semco was only about thirty percent complete by 1998:

> *Still the rewards have already been substantial, we've taken a company that was moribund and made it thrive, chiefly by refusing to squander our greatest resource: our people. Semco has grown six-fold despite withering recession, staggering inflation, and chaotic national policy. Productivity has increased nearly seven-fold. Profits have risen five-fold. And we have had periods of up to fourteen months in which not one worker has left us. We have a backlog of more than 2,000 job applications, hundreds of people who say they would take any job just to be at Semco. As a matter of fact, our last help-wanted newspaper generated more than 1,400 responses in the first week...*

Most importantly, changing the company changed the lives of Semco Associates. Semler liked to recount the following anecdote:

> *Not long ago, the wife of one of our workers came to see a member of our human resources staff. She was puzzled about her husband's behavior. He no longer yelled at the kids, she said, and asked everyone what they wanted to do on the weekends. He wasn't his usual grumpy, autocratic self. The woman was worried. What, she wondered, were we doing to her husband? We realized that as Semco had changed for the better, he had too.*

Points for Consideration

The biggest challenge facing any business is change. Many managers consider the changes that Semco went through to be too extreme and even unnecessary in light of the concurrent global environment. Many argue that such drastic changes were not necessary to achieve the same level of success.

Finally, how will Semco need to change in the future? What is Semco's potential?

EXHIBIT 1 The Four Basic Models of Organizational Behavior

The Autocratic Model: The autocratic model is based on structural sources of power within the organization. Managers thus derive power from their positions in the corporate hierarchy. Central to this theory is management's belief that it knows, more than other employees, what is best for the company. Succinctly stated, managers make the decisions and employees follow their orders. Managers may feel the need to resort to threats to accomplish company goals, and, indeed, fear of managers is one of the main sources of motivation for employees. Salary is the other main source of motivation, and there are few other satisfiers.

The Custodial Model: The custodial model assumes that the most powerful motivation for employees is the desire for economic wealth and security. The developers of this model believed that productivity was directly related to employee satisfaction, which in turn comes from handsome compensation. The custodial theory informed the creation of the first fringe benefits and group plans. The manager's role is reduced to balancing the increased productivity derived from a well-compensated work force with the need to minimize operating expenses.

The Supportive Model: The supportive model focuses on employees' perceived need for positive reinforcement from managers. This psychological support builds and maintains employees' sense of personal worth, thus creating a productive workforce. Thus, management's responsibility is to supply an environment in which employees can continuously learn and grow as individuals. In addition, employee participation fulfills the basic human need for belonging. Ultimately, the potential for employees to grow and feel a sense of solidarity with co-workers determines their level of productivity.

Collegial Model: The collegial model incorporates aspects of all of the preceding models, while advocating an even higher level of employee participation. Managers are facilitators rather than bosses. As in the Supportive Model, greater employee participation is used to cultivate feelings of self-worth and belonging in employees. Productivity is maximized by having employees work in self-managed teams. Motivation is derived from the desire for achievement, personal growth, self-fulfillment, and recognition. Greater participation is regarded as the mere beginning of a self-sustaining process which compels employees to accept more and more responsibility and seize more opportunities.

EXHIBIT 2 Where Does Participative Management Fit In?

Participation motivates employees through multiple mechanisms. Obviously, the chance to contribute in a meaningful way gives them a sense of accomplishment and self-realization. More subtle, however, is the bond that participation creates between employees and their peers. As employees work more closely, they begin to feel solidarity with co-workers and, consequently, to seek their approval. This new relationship gives each employee a very *personal* stake in the success of teamwork. Social pressures to pull one's weight then become powerful sources of motivation.

This fact that participation affects productivity through many different mechanisms suggests that managers in organizations with vastly different structures can all use participation to achieve their goals. For example, Theory X focuses solely on participation's effects on employee morale. It suggests that by improving morale through necessarily limited participation, managers can lessen employee resistance to their mandated policies and decisions. In this case, participation is viewed as a means of controlling workers. In contrast, Theory Y focuses on the maximum utilization of a company's limited human resources. Participation in this context seeks to unleash the full potential of all employees and suggests a greater level of participation.

Management's goals are the basis of the difference between these two theories of participation. Management must decide exactly what it is trying to accomplish through participation before establishing suitable levels. Most managers would probably not be comfortable with the level of employee participation in Semco for fear of losing their power or perhaps their jobs. Admittedly, greater employee participation does entail sacrifices for upper management. The returns accrue to other employees and to the organization as a whole.

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